

PwC Government Contract Compliance Quarterly Review

Providing critical regulatory updates to Government contracts and compliance professionals

PwC Government Contracts Practice

Q1 Government fiscal year 2014 – January 30, 2014

New Contractor Allowable Employee Compensation Cost Limitation

On December 26, 2013, President Obama signed the Bipartisan Budget Act (BBA) of 2013 and the National Defense Authorization Act (NDAA) for Fiscal Year 2014 into law. Both pieces of legislation contained limitations on allowable compensation costs for contractor employees under certain government contracts. The two laws contained different limitation amounts with the BBA limiting allowable compensation to \$487,000 and the NDAA limiting it to \$625,000. Both laws specified annual adjustment of the limit based upon a broad Bureau of Labor Statistics employment cost index.

The BBA and NDAA applied the limits to both civilian and defense contracts. The allowable cost limitations apply to contract awards and modifications where cost analysis is required, for contracts awarded on or after June 24, 2014. That includes cost reimbursable contracts and fixed-price contracts or modifications negotiated based upon costs among others. Employee compensation subject to limitation is composed of:

- Wages,
- Bonuses,
- Deferred compensation, and
- Employer contributions to defined contribution pension plans.

Other fringe benefits are not included in the allowable compensation calculation.

While other provisions of the BBA and NDAA sections addressing the allowable compensation limitations were similar, there were differences. The Federal Acquisition Regulation Council and the Defense Acquisition Regulation Council will need to resolve the differences in amending the FAR and DFARS to implement the new limitation on allowable contractor employee compensation costs.

Many contractors will have up to three different allowable compensation cost limitations applicable to individual contracts after the implementation of the new limitation for contract awards on or after June 24, 2014. They include the legacy FAR senior executive compensation benchmark to the 5 most highly compensated employees in management positions within each home office or segment, the expansion of the compensation benchmark amount on defense contracts to all employees on contracts entered into on or after December 31, 2011, and the new contractor-wide limitation on applicable civilian and defense contracts. Contractors will need to decide if and how they will maintain different direct and indirect rates for contracts subject to the different limitations.

Business Systems Withholding Statistics Update

DCMA provided statistics on contractor business system disapprovals and contract payment withholding as of October 22, 2013. 75 Headquarters Review Panels had been convened to consider ACO requests for system disapprovals based upon findings of business system significant deficiencies. The number of requests by business system type are as follows:

- 30 Accounting
- 16 Government Property
- 14 Estimating
- 10 Earned Value Management System (EVMS)
- 5 Purchasing
- 0 Material Management and Accounting System (MMAS)

64 of the 75 systems reviewed by the Headquarters Review Panel systems were disapproved. Of those 64, 16 had subsequently been (re)approved. Of the remaining 48 disapproved systems, 17 had payment withholds against them. 9 had withholds at 5%, 7 had withholds at 2%, and 1 had withholding at 1% based upon a legacy contract term. \$305.9M had been withheld in total as of October 22, 2013.

DOD Allowed to Consider Contractor Supply Chain Risk in Procurements Related to National Security

Effective November 18, 2013, an interim rule updates the DFARS to allow the DOD to consider the impact of supply chain risk in specified types of procurements related to national security systems (NSS). The rule establishes a new provision (DFARS 239.73) and clause for inclusion in all solicitations and contracts involving the development or delivery of any information technology, whether acquired as a service or as a supply, because portions of these contracts may be used to support or link with one or more NSS. Supply chain risk is defined as the risk that an adversary may sabotage, maliciously introduce unwanted function, or otherwise subvert the design, integrity, manufacturing, production, distribution, installation, operation, or maintenance of a NSS so as to surveil, deny, disrupt, or otherwise degrade the function, use, or operation of such system. The Government may consider information, public and non-public, including all-source intelligence, relating to an offeror and its supply chain. If the Government exercises the authority to limit disclosure of information, no action undertaken by the Government under such authority shall be subject to review in a bid protest before the Government Accountability Office or in any Federal court. Ref. DFARS Case 2012–D050, 78 Fed. Reg. 69268.

DCAA Issues Audit Guidance Reducing Audit Requirements for Low Risk Incurred Cost Proposal Less Than \$250M

On October 23, 2013, the DCAA issued revised guidance to its auditors, reducing the number of contractor incurred cost proposals (ICPs) requiring audit by eliminating many low risk ICPs. For ICPs with audit dollar values (ADV) greater than \$1M and less than \$250M that are considered “low risk”, a sampling approach will be used. Low risk ICPs with less than \$1M ADV will not be audited. Low risk ICPs with ADVs greater than \$1M but less than \$250M will be subject to sampling with increasing sampling rates for higher ADV ICPs (e.g., 10% random selection for low risk ICPs between \$50M and \$100M). In addition to sampling, ICPs with ADVs greater than \$100M but less than \$250M will be subject to mandatory audit once every three years. All ICPs with ADVs of \$250M or more and those not determined to be low risk will still be subject to audit. The guidance provides criteria for evaluating if ICPs are considered low risk, such as prior ICP audit history, fraud indicators and other audit results. Ref. DCAA MRD 13-PPD-021(R).

FAR Final Rule Requires Additional Service Contract Reporting

Effective January 30, 2014, a final rule amends the FAR requiring contractors to provide annual reports of service contract invoiced amounts and direct labor hours expended under prime contracts, inclusive of first tier subcontractors. The reporting supports executive agencies in fulfilling their requirement to submit to the OMB an annual inventory of activities performed by service contractors. DOD contracts are exempt from this rule because the DOD is already required to develop an annual service contract inventory. Reporting is required for all cost-reimbursement, time-and materials, and labor-hour service contracts and orders, and all fixed-price service contracts. The FAR Council also determined the rule should apply to contracts for the acquisition of commercial items in order to fulfill the intended result of the statutory requirement for increased visibility of contracted services. Contract applicability thresholds apply. Ref. FAR Case 2010-010, 78 Fed. Reg. 80369.

DFARS Final Rule Addresses Safeguarding Unclassified Controlled Technical Information

Effective November 18, 2013, a final rule amends the DFARS addressing requirements for safeguarding unclassified controlled technical information. The final rule addresses safeguarding requirements that cover only unclassified controlled technical information, and reporting the compromise of unclassified controlled technical information. Based upon comments received to a proposed rule, published June 29, 2011, the scope of the rule was modified to reduce the categories of information covered. The new DFARS subpart 204.73 and clause requires contractors to provide adequate security to safeguard unclassified controlled technical information from compromise for information resident on or transiting through the contractor’s unclassified information systems. The clause also requires reporting to the DOD within 72 hours of discovery of any cyber incident involving potential compromise of unclassified controlled technical information. Ref. DFARS Case 2011–D039, 78 Fed. Reg. 69273.

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